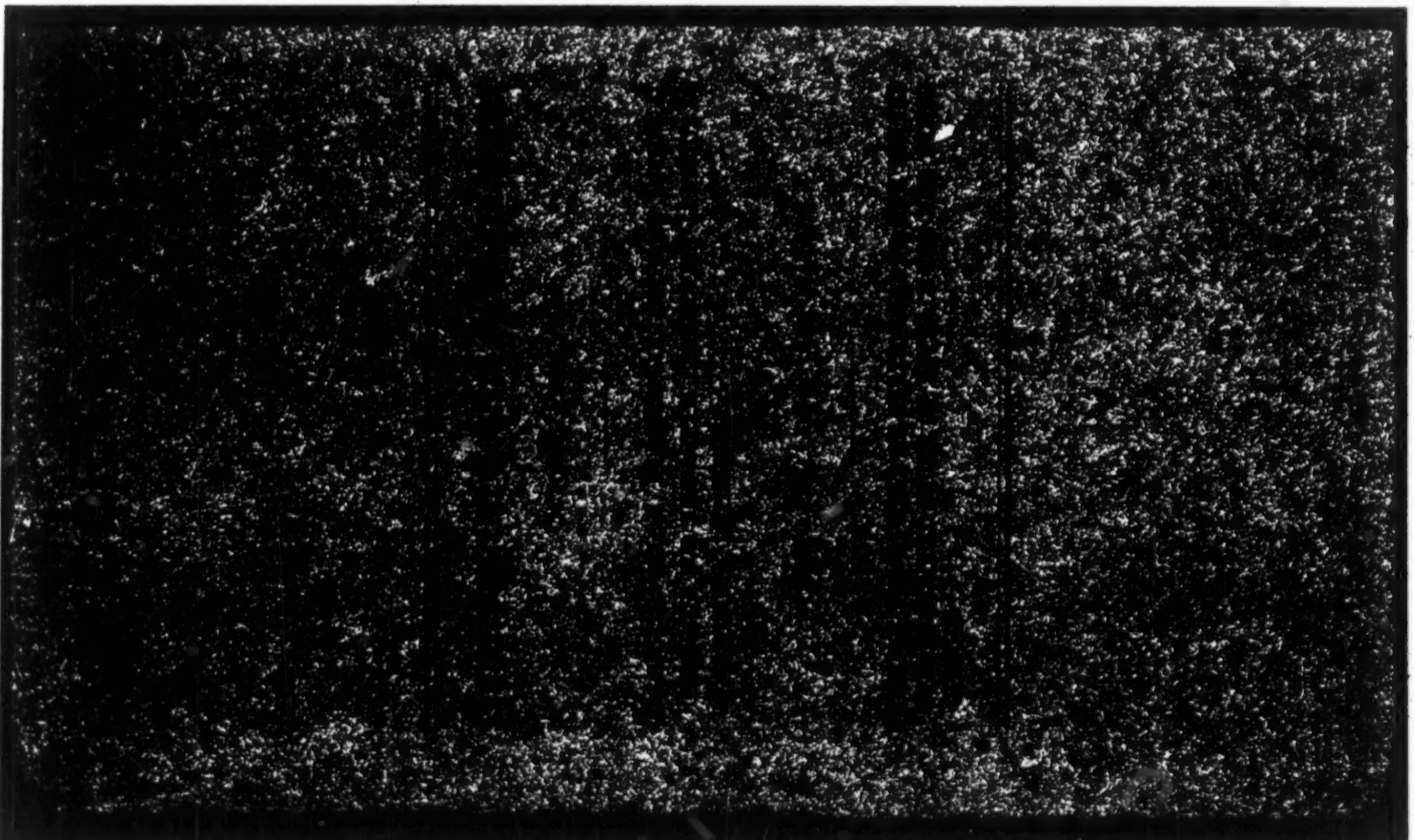

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114740—36

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, PETITIONER

v.

OBISPO OIL CO., A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Galen H. Welch, former Collector of Internal Revenue for the Sixth Collection District of California, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in the above cause on September 28, 1936. The Solicitor General requests that the review be limited solely to the question of jurisdiction hereinafter presented.

OPINIONS BELOW

The first opinion of the District Court of the United States for the Southern District of California is reported in 48 F. (2d) 872; the second

opinion (R. 25–43) is not reported. The opinion of the Circuit Court of Appeals is reported in 85 F. (2d) 860.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 28, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

After the Commissioner of Internal Revenue has granted a special assessment of profits taxes, pursuant to Sections 327 and 328 of the Revenue Act of 1918, may a court, in an action for refund of income taxes, revise the Commissioner's determination of the taxpayer's net income?

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 8–10.

STATEMENT

The District Court made special findings of fact (R. 27–41). Those pertinent to the question here involved may be summarized as follows:

Pursuant to Sections 327 and 328 of the Revenue Act of 1918, the Commissioner of Internal Revenue determined the profits taxes of the taxpayer for the calendar year 1920 to be $142,765.73, or 9.67% of its net income (R. 40). The taxpayer's

income tax for the same year was determined by the Commissioner as follows (R. 40):

Net income		$1,476,330.52
Less:		
Profits tax, Section 328	$142,765.73	
Interest on U. S. obligations, not exempt	86,134.16	
Exemption	2,000.00	
		230,899.89
Balance subject to 10% tax		1,245,430.63
Amount of tax at 10%		124,543.06

Thereafter, on December 6, 1927, the taxpayer filed a claim for refund, setting up several grounds for recovery (R. 34–36). The claim was rejected on or about February 14, 1928, and the taxpayer filed its original complaint in the District Court on December 2, 1928 (R. 37).

The District Court found that the Commissioner had overstated the net income by $40,102.44, determined as follows (R. 41–42):

Overstatement of two items: (1) $47,461.37 representing over-valuation of Liberty bonds turned over to the taxpayer by the Receiver in 1920; and (2) $159,751.56 representing proceeds from the sale of oil produced prior to March 11, 1914, together with interest during the years 1914 to 1919, inclusive, under certain agreements with the Standard Oil Company.

Understatement of two items: (1) $40,683 representing capital expenditures in connection with litigation which were erroneously allowed as de-

ductions; and (2) $126,427.49 representing the depletion deduction allowed by the Commissioner on oil and gas produced prior to April 20, 1920.

The District Court concluded that it had jurisdiction of the subject matter of this action to the extent of determining the correct amount of income tax, even though the profits taxes of the taxpayer for the calendar year 1920 had been determined under the special assessment provisions of the 1918 Act (R. 41). The tax on the net income found to be overstated was found to be $4,010.24, and the District Court entered judgment against petitioner accordingly (R. 44–45). On appeal, the Circuit Court of Appeals sustained the District Court.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the District Court had jurisdiction of the subject matter of this action to the extent of revising the taxpayer's net income after it had been determined by the Commissioner for the purpose of computing the profits taxes as provided in Sections 327 and 328 of the Revenue Act of 1918.

2. In entering judgment for the taxpayer.

REASONS FOR GRANTING THE WRIT

Taxpayer here has invoked the discretionary jurisdiction of the Commissioner pursuant to Sections 327 and 328 of the Revenue Act of 1918, al-

leging an abnormal condition affecting income for the year 1920. Pursuant to those sections the privilege of a special assessment was granted to taxpayer after the amount of net income had been agreed upon. By that agreement, the taxpayer abandoned the position that there had been any error of law or of fact in the determination of net income, and is now estopped from retracting its assent and resuming the abandoned ground.

The decision of the court below to the contrary is in conflict with *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73; *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; *Cleveland Automobile Co.* v. *United States*, 70 F. (2d) 365 (C. C. A. 6th), certiorari denied, 293 U. S. 563; and *Michigan Iron & Land Co.* v. *United States*, 10 F. Supp. 563 (C. Cls.). In the last case the Court of Claims stated (p. 570):

> As a result of the granting of special assessment, the plaintiff's taxes were reduced from $462,000 to $116,000. No appeal was taken to the Board of Tax Appeals from that determination, and the taxes were assessed and paid. It is now proposed by the plaintiff that this court set aside this discretionary act of the Commissioner and find a different value for the timberlands as of March 1, 1913. This would entail going into one of the factors which entered into the exercise by the Commissioner of his discretionary power. In *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, 507, 53 S. Ct. 413, 415, 77 L. Ed. 921, the Supreme Court holds:

> "It is beyond the power of a court to usurp the Commissioner's function of finding that special assessment should be accorded, and equally so to substitute its discretion for his as to the factors to be used in computing the tax."

See also *Central Iron & Steel Co.* v. *United States,* 6 F. Supp. 115 (C. Cls.), certiorari denied, 293 U. S. 563; *W. H. Bradford & Co.* v. *United States,* 6 F. Supp. 117 (C. Cls.); *Con P. Curran Printing Co.* v. *United States,* 14 F. Supp. 638 (C. Cls.)

The amount of taxpayer's net income is one of the essential factors in determining the necessity and extent of relief under Sections 327 and 328. *Heiner* v. *Diamond Alkali Co.,* 288 U. S. 502. Modification of this factor after the Commissioner has granted a special assessment amounts to an abrogation of the Commissioner's administrative discretion in the computation of profits taxes, and defeats the very purpose for which the special provisions were enacted. *Cleveland Automobile Co.* v. *United States,* 70 F. (2d) 365 (C. C. A. 6th), certiorari denied, 293 U. S. 563. Indeed, to protect the revenues, the Commissioner, unless barred by the statute of limitations, would be obligated to make a recomputation or even a complete reexamination of the taxpayer's position, which might result in a denial of relief under the special assessment sections. This obligation placed by the court below upon the Commissioner plainly nullifies

his discretion, contrary to repeated decisions of this Court. *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73.

CONCLUSION

The court below has failed to apply principles found in the decisions of this Court which we believe to be controlling and has decided a question in a way which is in direct conflict with decisions of other Circuit Courts of Appeals and the Court of Claims.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted, limited to the question of the jurisdiction of the District Court.

STANLEY REED,
Solicitor General.

DECEMBER 1936.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1093:

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit

upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations

prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

U. S. GOVERNMENT PRINTING OFFICE: 1938